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No. 73-400

In the Supreme Court of the United States

OCTOBER TERM, 1973

FELIX BENITEZ REXACH, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 38a-75a) is not yet officially reported. The opinion of the district court (Pet. App. 2a-37a) is reported at 331 F. Supp. 524.

JURISDICTION

The judgment of the court of appeals was entered on June 27, 1973 (Pet. App. 38a). The petition for a writ of certiorari was filed on August 31, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether a taxpayer bears the burden of proof in a tax collection suit with respect to the issues concerning the merits of the tax liability.

2. Whether the United States was collaterally estopped from asserting that 57 1/2 percent of a 1959 payment and 100 percent of a 1961 payment made to petitioner on construction contracts constituted taxable income because it had been stipulated during a prior litigation for the years 1951 through 1958 that only one-eleventh of the payments on such construction contracts were taxable.

3. Whether Section 162(c) of the Internal Revenue Code of 1954 forecloses the deductibility as ordinary and necessary business expenses of kickback payments made by petitioner in 1959 to General Trujillo of the Dominican Republic.

STATUTE INVOLVED

The pertinent provisions of Section 162 of the Internal Revenue Code of 1954 are set forth at Pet. App. 1a-2a.

STATEMENT

In 1964, the United States instituted this tax collection suit against petitioner seeking the entry of judgment on federal income tax assessments for the calendar years 1959 and 1961 and the foreclosure of liens securing the tax assessment (Pet. App. 2a).

During a prior tax collection suit against petitioner for the years 1951 through 1958, petitioner testified that he had no records from which he could reconstruct his costs under certain construction contracts he performed on behalf of the government of the Dominican Republic (Pet. App. 39a). As a result, it was stipulated for this prior litigation that the profits from the various construction contracts performed during the years 1951 through 1958 amounted to one-eleventh of the original contract prices (equivalent to a ten-percent profit margin) and that the percentage of completion of contract method

of accounting would be utilized. Using this method, the contract prices were allocated in equal monthly amounts over the maximum number of months within which each contract was to be completed (Pet. App. 5a-6a, 39a, 47a).

Petitioner's tax liabilities, however, were thereafter substantially reduced by a claimed $1,552,000 foreign tax credit resulting from a Dominican gross receipts tax paid in that amount. It was later discovered that the $1,552,000 used by petitioner to pay his Dominican taxes was received by him in 1961 as compensation for claimed additional expenses on a construction contract for the harbor of Boca Chica. This additional payment was not covered by the original contract. (Pet. App. 14a-15a, 40a.)

General Trujillo was assassinated in May 1961, shortly after the transactions involving the $1,5522,000. Petitioner's existing contract with the Dominican Republic was cancelled, he was sued on past contracts, and a sequestrator took possession of all of his assets. (Pet. App. 40a.)

After an audit of petitioner's returns for the years 1959 through 1961 by Internal Revenue Service personnel who were able for the first time to examine petitioner's records in the Dominican Republic, the United States assessed deficiencies, including fraud penalties, against petitioner of $662,052.62 for 1959 and $2,272,042.95 for 1961, and brought this collection suit in 1964 (Pet. App. 41a). The 1959 assessment was based largely on a determination that petitioner earned a profit of 57 1/2 percent on construction projects at the Port of Azua and on a Customs House in Ciudad Trujillo (Pet. App. 47a, 48a). The 1961 assessment was based largely on the additional $1,552,000 payment received

on account of the Boca Chica project and income from a dredging project at the Yuna River (Pet. App. 41a).

The district court held that the government had failed to meet its burden of proof, that it was estopped from asserting that petitioner's percentage of profit for the years at issue was greater than had been stipulated for earlier years, and that petitioner's 1959 kickback payments to Trujillo were deductible (Pet. App. 2a-37a).[1] On the government's appeal, the First Circuit reversed on each of these three issues and remanded the case,[2] holding that the taxpayer bore the burden of proof in a tax collection suit with respect to the merits of the liability, that the United States was not estopped from maintaining that petitioner received greater percentages of profits on the 1959 and 1961 payments than had been previously stipulated for earlier years, and that Section 162(c) of the Internal Revenue Code of 1954 foreclosed deductibility of the 1959 kickback payments made by petitioner to General Trujillo (Pet. App. 38a-75a).

ARGUMENT

1. Petitioner argues (Pet. 18-20) that the ultimate burden of proof in a tax collection suit with respect

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[1] After trial in 1966 petitioner moved for summary judgment, contending that he was not taxable because he was not a United States citizen. The district court ruled against petitioner and the court of appeals affirmed. *Benitez Rexach* v. *United States*, 390 F. 2d 631 (C.A. 1), certiorari denied, 393 U.S. 833.

[2] The court of appeals (Pet. App. 46a-47a) remanded the case with instructions that the district court determine "whether the taxpayer suffered as to some or all of the issues from an erroneous, though reasonable, misunderstanding of his evidentiary burden and therefore whether the record should be reopened." The fraud issue was also remanded. The government, of course, had the burden of proof as to this issue (Pet. App. 74a).

to the merits of the tax liability is on the government and that the contrary decision of the court of appeals is in conflict with *United States* v. *Lease*, 346 F. 2d 696 (C.A. 2), and *Bar L Ranch, Inc.* v. *Phinney*, 426 F. 2d 995 (C.A. 5). In advancing this contention, petitioner stresses certain ambiguities in those opinions and ignores later decisions of the Second and Fifth Circuits which hold, in accord with the court of appeals here, that the taxpayer bears the burden of proof in a tax collection suit.

Subsequent to its decision in *Lease*, the Second Circuit, sitting *en banc* in *Lesser* v. *United States*, 368 F. 2d 306, 310, cited its earlier holding in *Lease* with approval and unequivocally held that, with respect to a counterclaim for taxes by the United States in a taxpayer's refund suit, the taxpayer bore the burden of convincing the trier of fact by a preponderance of the evidence. As the Second Circuit explained, given the fact that taxpayers have the burden of proof in refund suits, if the rule were otherwise in collection suits "the tax bar would quickly move to make the task of the government more difficult by advising clients not to pay taxes under protest but * * * [force] the government to collect by levy and suit." Similarly, after its decision in *Bar L Ranch, supra*, the Fifth Circuit in *Liddon* v. *United States*, 448 F. 2d 509, 513-514, certiorari denied, 406 U.S. 918, held that the taxpayer bore the burden of proving that the tax assessment was erroneous as to both his refund claim and the government's counterclaim. This rule was followed in *Thrash* v. *O'Donnell*, 448 F. 2d 886 (C.A. 5), which cited *Bar L Ranch* with approval (*id.* at 890, n. 8), and is consistent with the decisions of other circuits. See, *e.g.*, *Psaty* v. *United States*, 442 F. 2d 1154 (C.A. 3); *Plisco* v. *United States*, 306 F. 2d 784 (C.A. D.C.), certiorari denied, 371 U.S. 948.

2. Contrary to petitioner's contention (Pet. 14-18), the doctrine of collateral estoppel does not bind the government to use, for the 1959 and 1961 construction contract payments, the one-eleventh profit percentage stipulated in the 1951-1958 litigation. It is dubious whether that doctrine applies to stipulated, as distinguished from litigated, issues. In any event, as this Court held in *Commissioner* v. *Sunnen,* 333 U.S. 591, 601, if there is a subsequent modification of the significant facts or the underlying law in cases involving different tax years, collateral estoppel does not govern the determination for later years.

There was such a modification in this case. Because of the unavailability of petitioner's records, the parties stipulated in the earlier case that the profits from the construction contracts, including the Boca Chica contract, performed during the years 1951 through 1958, amounted to one-eleventh of the original contract prices (equivalent to a ten percent profit margin) (Pet. App. 39a, 47a). This stipulation, however, could not govern the taxability of the 1961 payment of $1,552,000, which was totally in excess of the price set for the Boca Chica contract (Pet. App. 53a-54a). Under these circumstances, the court of appeals correctly held that the change in facts made the one-eleventh formula inapplicable to the additional $1,552,000 Boca Chica payment and that therefore such payment was entirely includable in petitioner's taxable income.

Similarly, there was a change in relevant facts with respect to the 1959 payments received by petitioner under the Azua and Customs House contracts. Contrary to the prior litigation in which a 10 percent profit margin was stipulated for these contracts, the Internal Revenue Service was able for the first time to send

agents to the Dominican Republic in 1962 to conduct an audit. These personnel viewed petitioner's construction projects and examined his records (Pet. App. 40a, 48a). As a result of these investigations, important new evidence was developed and the Internal Revenue Service accordingly determined that petitioner earned a profit of 57 1/2 percent on his contracts in the Dominican Republic (Pet. App. 48a). Given the existence of these subsequently discovered facts, the court of appeals correctly refused to apply the 10 percent stipulated profit margin used in the prior litigation to the 1959 payments.[3]

3. Finally, petitioner contends (Pet. 20-22) that his 1959 kickbacks to General Trujillo of one-third of the contract price are deductible despite the addition of Section 162(c) to the Internal Revenue Code, on September 2, 1958, through the enactment of Section 5(a) of the Technical Amendments Act of 1958, 72 Stat. 1606, 1608. That provision forecloses a business expense deduction for payments made to foreign government officials if such payments would be unlawful under the laws of the United States if such laws were applicable. Section 5(b) of the Technical Amendments Act of 1958 provides that Section 162(c) "shall apply only with respect to expenses paid or incurred after the date of enactment of this Act."

Petitioner bases his claim to deductbility on the sole assertion that Section 162(c) is inapplicable to the kickbacks at issue because they were paid pursuant to

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[3] In light of the change of significant facts, *Fairmont Aluminum Co.* v. *Commissioner*, 222 F. 2d 622 (C.A. 4), certiorari denied, 350 U.S. 838, cited by petitioner (Pet. 16), is not in conflict with the decision below.

obligations that were entered into prior to 1959. However, under the percentage of completion method of accounting used by petitioner, he was permitted to deduct only those "expenditures made during the taxable year in connection with the contract." Treasury Regulations (1954 Code), §1.451-3(b)(1). Thus, even assuming *arguendo* the existence of an obligation by petitioner to make such payments prior to September 2, 1958,[4] the effective date of the statute, the controlling date is when they were actually paid. Since they were paid in 1959, the court of appeals correctly held (Pet. App. 52a) that they were nondeductible under Section 162(c).

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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[4] The record lacks any evidence showing any formal contract between petitioner and General Trujillo. At best, there was an informal understanding.

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